

[The hasty 2002 law gets a potent constitutional challenge](#)

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Editorial

Congress wants to wallop business with even more regulation in the wake of the financial panic, but perhaps the Members should pause on Monday and visit the Supreme Court. The Justices will hear arguments on whether major portions of the last great Congressional overreaction, the 2002 Sarbanes-Oxley Act, are constitutional.

Free Enterprise Fund v. Public Company Accounting Oversight Board was brought in 2006 by Brad Beckstead, whose small Nevada accounting firm endured a costly examination under Sarbox rules. At issue is whether the Public Company Accounting Oversight Board, or PCAOB, which supervises compliance with the law, violates the Constitution's separation of powers. Under the Appointments Clause, all "officers" of the United States must be appointed by the President and accountable to him—a condition PCAOB members do not meet.

The board's five members are instead hired by the commissioners of the Securities and Exchange Commission, who are appointed by the President. This arrangement passed muster in a 2-1 decision by the D.C. Circuit Court of Appeals, on the dubious grounds that the members were "inferior officers" and accountable to the President through the SEC. Never mind that they are not "directed and supervised" by the SEC, the traditional requirement for inferior officers.

The dissenter on the D.C. Circuit panel, Judge Brett Kavanaugh, called the case the most important separation of powers case in 20 years and said the appeals court had created a constitutional hash. Though the PCAOB "performs numerous regulatory and law enforcement functions at the core of the executive power," he wrote, for the first time in U.S. history we have "an independent agency whose heads are appointed by and removable only for cause by another independent agency."

The PCAOB has indeed grown as a politically unaccountable entity with vast power to regulate business. Texas Senator Phil Gramm warned at its creation that Congress was setting up a board with "massive unchecked power" to "make decisions that affect all accountants and everybody they work for, which directly or indirectly is every breathing person in the country."

Massive is the right word. The accounting board's wide-open mandate—to make whatever rules "may be necessary or appropriate in the public interest or for the protection of investors"—has cost the economy nearly \$1 trillion, according to a study by AEI and the Brookings Institution. The benefit is supposed to be investor protection. But despite these costs, the law did nothing to warn about the meltdown of mortgage-backed securities, much less expose Bernie Madoff or other fraudsters.

These realities contributed to the welcome 37-32 November vote in the House Financial Services Committee to exempt small businesses from section 404b of Sarbox, which governs audit requirements. Sponsored by Democrat John Adler and Republican Scott Garrett, both of New Jersey, the provision was supported by the Obama Administration and 10 Democrats joined Republicans in support.

As the Supremes now take their turn, the case has implications the regulation-loving press corps hasn't noticed. A decision to uphold the PCAOB would open the door for Congress to create any number of equally unaccountable regulators across the economy. However, a ruling against the PCAOB could bring down the whole law because Sarbox does not have a "severability clause," which means that if one part goes down the entire law may be invalidated.

Debates over the Appointments Clause haven't typically divided the Supreme Court along liberal and conservative lines, so the outcome is hard to handicap. As Hans Bader and John Berlau of the Competitive Enterprise Institute point out, in the 1995 case *Ryder v. United States*, the High Court ruled unanimously that "an individual or firm disciplined by a government agency can challenge that discipline if agency officials were improperly appointed."

At stake here isn't merely a poorly written law that has done great economic harm. The issue is whether Congress, in its haste, can ignore the Constitutional order that has ensured accountable government for 230 years.